Kroger Annual Report -- 1984
America's Corporate Foundation; 1984; ProQuest Historical Annual Reports
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KROGER ANNUAL REPORT

The Kroger Co., a leading
U.S. food and drug retailer, had
sales in 1984 of $15.9 billion, up 4.5%.
Earnings were
$156.6 million, up 23.9%.
Earnings per share
were $3.[illegible], up 26.4%.

'84

FINANCIAL HIGHLIGHTS FOR 1984

	1984	1983	Change
Sales	**$15.9 billion**	$15.2 billion	+4.5%
Net earnings	**$156.6 million**	$127.1 million	+23.3%
Net earnings per share	**$3.49**	$2.76	+$.73
Dividends paid on common stock	**$90.0 million**	$85.2 million	+5.6%
Dividends per share	**$2.00**	$1.91	+$.09
Return on average equity	**14.1%**	11.8%	
Capital expenditures	**$310.0 million**	$368.9 million	−16.0%
Real estate data			
Food stores			
Opened	**46**	81	
Remodeled	**90**	81	
Closed	**156**	71	
Total area (sq. ft.)	**43.9 million**	46.1 million	
Drug stores			
Opened and acquired	**26**	65	
Remodeled	**11**	8	
Closed	**14**	22	
Total area (sq. ft.)	**7.0 million**	6.8 million	
Convenience stores			
Opened and acquired	**99**	8	
Closed	**8**	8	
Total area (sq. ft.)	**1.1 million**	0.8 million	

TO OUR FELLOW SHAREOWNERS

Lyle Everingham William G. Kagler

The Kroger Co. significantly improved its sales and earnings in 1984. Perhaps even more important, Kroger improved the quality of its performance.

Simply stated, Kroger managed its business better. By so doing, the company was able to take advantage of opportunities the more favorable retail environment presented during the year. This was especially the case in our Kroger Food Stores division, which had been so severely challenged during 1982 and 1983.

In turning around from the disappointing results of 1983, Kroger looked inward, examining business plans and the assumptions underlying them, examining management techniques and the attitudes shaping them; in sum, examining the kind of company Kroger was and comparing it to what we want it to be.

The decisions made as a result of this analysis were at times difficult, even painful, but in our view entirely necessary.

The decisions have not caused Kroger to change its overall business goal: satisfying an expanding base of customers with quality products, at good values, offered with a high level of service in clean, convenient and attractive store facilities.

But Kroger has changed, and improved, the way it is designing and executing its merchandising, distribution and manufacturing plans.

For one, Kroger has more clearly defined its priorities. We are first and foremost a food and drug retailing organization. Our manufacturing operations are — and will continue to be — a vital component of Kroger's total business. Their primary and essential role is to support Kroger's retail merchandising efforts.

For another, decision-making throughout the company is now more dispersed and more flexible. Kroger, Dillon, SupeRx and Manufacturing managers are being given more latitude and authority to respond quickly and decisively to rapidly changing, diverse market conditions.

The company also has taken steps to enhance the quality of management decision-making. Kroger is better utilizing its research and analysis capabilities to more precisely choose everything from store locations to the proper mix of merchandise appropriate for specific trade areas — even to help select the store design that will work best for a given neighborhood.

Kroger's commitment to control expenses has been intensified in a number of areas. We're realizing substantial savings, for example, in the way we buy products and supplies.

We have stepped up our efforts to bolster productivity by improving the working environment for all employees. A major part of this commitment involves broadening communications to and from employees at all levels so that everyone in the company will better understand and share Kroger's objectives.

All of these actions have affected our recent performance. They will come even more into play in future years.

By substantially reducing administrative overhead and by negotiating significant labor contract modifications in 1984, Kroger was

able to trim its operating expenses and compete more effectively. The full impact of these expense reductions will be felt this year and beyond.

In implementing another long-standing priority — improving the return on Kroger's assets — the company learned a great deal more about how to analyze the basics of our business.

During 1984, we accelerated our asset redeployment program by closing and disposing of a number of poorly performing stores and reviewing ways to utilize more fully the productive capacity of our manufacturing operations. These actions were taken after a careful analysis of the critical factors affecting each of these assets.

This process will continue. It is being used to help us gauge more precisely the impact on our asset base of such variables as market and site selection, kinds of store facilities, and the effect of promotional efforts on actual performance. Our goal is to be increasingly more selective and more precise in planning where, what, when and how we build and expand our business.

The new sense of flexibility in managing our company will also sharpen Kroger's competitive skills. New retail entries, such as lower cost super warehouse operators, appeared on the scene in 1983 and provided keen competition in several markets. With the experience we gained competing with these operators in Indianapolis, Memphis and other markets in 1984, our people have devised a variety of programs suited to their particular competitive situations.

Common to all these Kroger programs are the characteristics of value, convenience and service. These qualities, we believe, attract customers and keep them coming back to a particular store. They form the heart of our sales strategy and storing plans for 1985.

To look at ourselves critically, as we did in 1984, was a revealing undertaking. In light of our poor performance in 1983, it was the only appropriate choice.

That we — all of us at Kroger — faced our shortcomings, and possessed the will power and the commitment to refine our corporate plans and improve their implementation, is perhaps the most important event of the past year. It helped 1984 to be a strong year, and it has set Kroger on a course that is already beneficial for you who share in the ownership of our enterprise and satisfying for all of us who work under its name.

Lyle Everingham
Chairman and
Chief Executive Officer

William G. Kagler
President

March 29, 1985

The heart of Kroger's improved sales and earnings in 1984 was the much stronger performance of the company's basic asset — the retail store.

Across the wide spectrum of retail facilities operated by Kroger Food Stores, Dillon and SupeRx, revitalized merchandising and improved operating efficiencies combined to boost overall corporate sales 4.5% to $15.9 billion, and earnings 23.3% to $156.6 million.

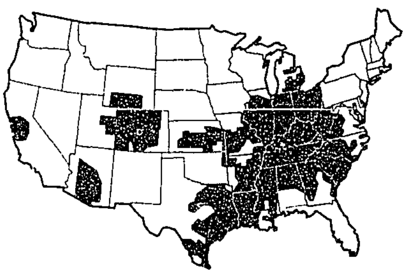
To a degree, Kroger's performance in 1984 was aided by more favorable operating conditions. The intense, price-driven competition of 1983 subsided somewhat in 1984 in many of our important markets. At the same time, employment rose while both food and general inflation remained low.

Yet the overriding factor behind Kroger's 1984 turnaround was our ability to obtain better, more productive and, ultimately, more profitable performance from our 2,379 food, drug and convenience stores.

Kroger Food Stores

Nowhere in the company was performance more strengthened than in Kroger Food Stores.

Despite a large number of store closings, Kroger Food Store sales reached $11.3 billion in 1984, or 1.6% higher than 1983 sales. Among identical stores, i.e., stores open at least one full year, the sales gain from 1983 averaged nearly 5%.



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Supermarkets represent The Kroger Co.'s biggest business, accounting for more than 90% of total sales. With 1,318 food stores in 24 states, Kroger is the nation's second largest food retailer. Supermarkets operate under the names of Kroger Food Stores in the South and Midwest, and King Soopers, Dillons Food Stores, Fry's Food Stores, City Market, Gerbes Supermarkets and Sav-Mor in the Midwest and West.

Significantly, with the effects of inflation removed, sales per square foot — a key measurement of retailing vitality — rose a full 2%. This increase, the first for Kroger since 1979, demonstrated the company's growing ability to operate successfully in a non-inflationary environment.

These improved figures were in part the result of heightened, more aggressive merchandising efforts. Our Grain Fed Beef promotion, launched early in the year, increased sales of Choice Grade beef by 9%, and contributed to an overall meat department sales gain of 4.5%. Heavy promotional efforts during the Thanksgiving-Christmas holiday season, moreover, helped fourth quarter sales reach a company record.

Kroger also gained more experience competing with lower cost warehouse store operators. As a result, we were able to hold our own and in most instances improve our customer base despite the presence of these new market entrants.

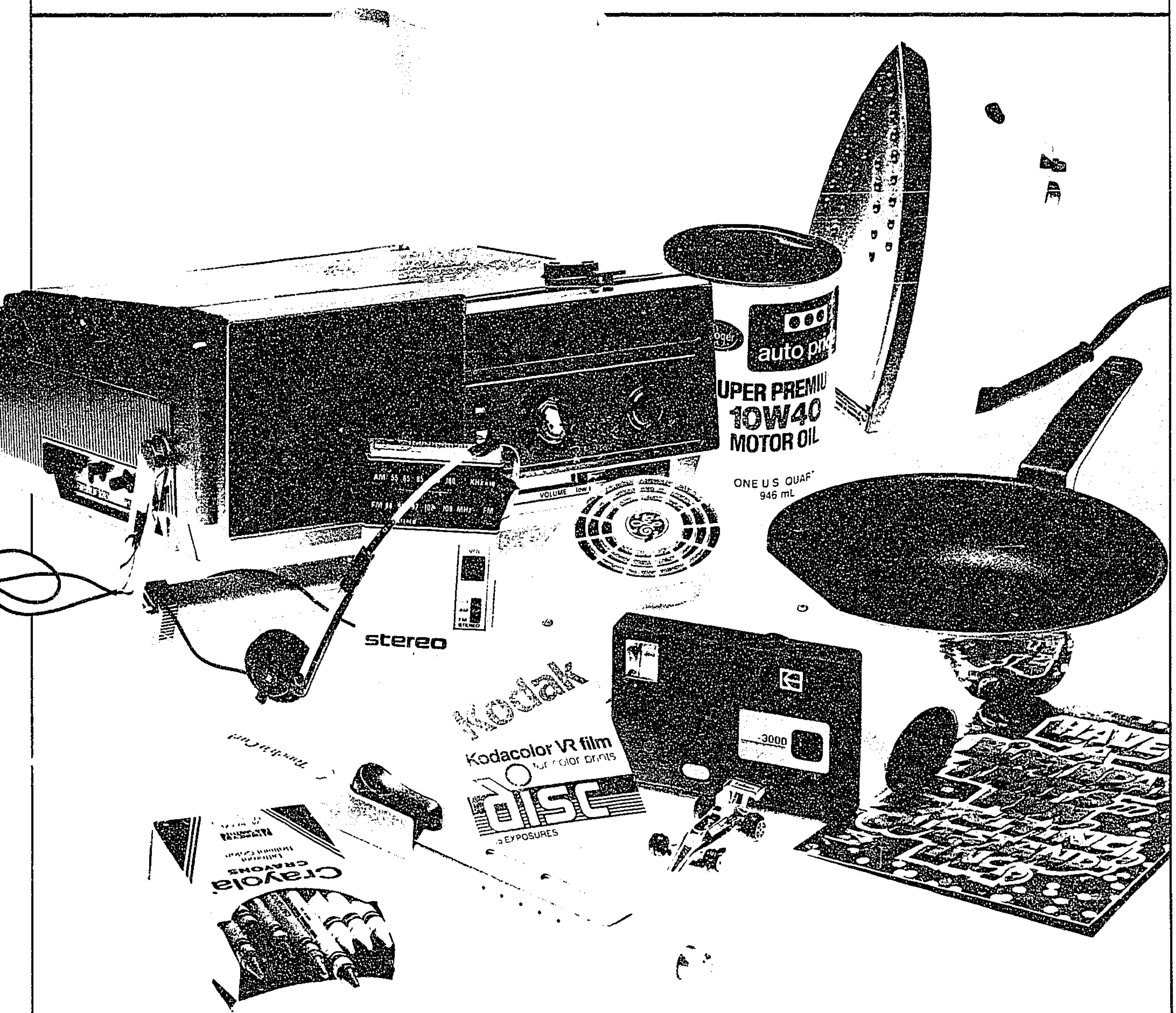
The better results also reflected the impact of widescale internal belt-tightening. One lesson learned forcefully in 1983 was the need to keep operating costs firmly in line. In 1984, this lesson was applied throughout the company, including more efficient product procurement systems, a reduction in administrative overhead and the negotiation of more cost competitive contracts.

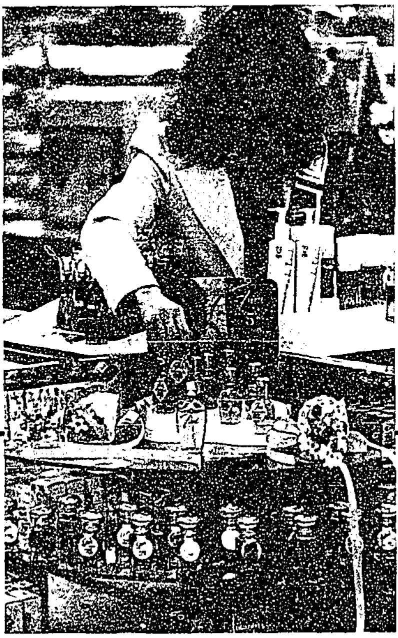
Kroger's asset redeployment program also contributed to the food stores' better performance. Store closings, 156 in all, primarily involved unprofitable facilities located in Pennsylvania and northeast Ohio. They had been served by the company's Erie Marketing area, which ceased operations during the year. Another 25 stores were closed and sold in Michigan. These were among 70 Kroger stores which closed in July after the company was unable to obtain a competitive labor contract; however, 45 of the stores later reopened when a new contract was ratified in August.

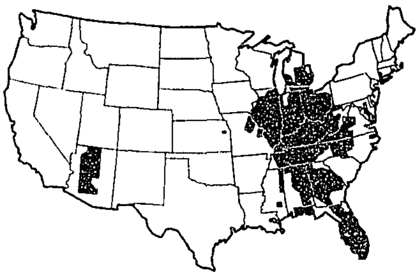
Besides removing poorly performing stores from the company's asset base, the redeployment program added to Kroger's positive cash flow during 1984. This is being used, in turn, to reduce debt, support the repurchase of outstanding common stock and finance expansion, such as the purchase by Dillon of the Florida-based Tom Thumb convenience store group.

Progress in reaching competitive parity in wage rates was a prominent factor in 1984's better results, although the full impact of new labor agreements reached during the year will be felt in 1985

More space than ever before in today's supermarket is devoted to general merchandise. For the shopper whose time is limited, the one-stop convenience of a modern combination store makes it easy to obtain more of what life requires — in a single shopping experience.







SupeRx operated 618 stores in 20 states at the end of 1984. Although SupeRx operates a majority of its drug stores in states where Kroger Food Stores are located, drug stores also are located in Arizona, Connecticut, Florida, New Jersey and New York. The above total includes 24 SupeRx Food and Drug Stores in Florida.

and beyond. Wage and benefit adjustments obtained in new contracts covered employees in approximately half of Kroger Food Stores.

Important as the settlements are in themselves, they also reflect greater understanding and effective leadership by many union leaders. They more realistically comprehend the nature of competition in the food retailing industry today. Their acknowledgment of the critical link between labor cost parity and Kroger's ability to grow, add jobs and remain competitive in the marketplace is helping to establish an improved climate for productive negotiations.

Dillon

Kroger's ability to focus attention on internal improvements in its food store group was bolstered by another strong performance from Dillon Companies in 1984.

Sales from Dillon's food stores rose to $3 billion, while convenience store sales contributed another $311 million.

Additionally, progress continued during the year on development of synergies between Dillon and Kroger, most notably in the areas of product ordering and distribution.

Dillon Companies opened three new combination stores during the year, bringing the total number of stores in operation to 227. The company also expanded its convenience store business with the mid-year acquisition of the 86-store Tom Thumb chain in western Florida and southern Alabama.

SupeRx Drug Stores

SupeRx drug store sales in 1984 demonstrated healthy growth, rising 8.8% to $859.5 million. This increase, moreover, came despite the fact that drug store square footage remained virtually unchanged from 1983.

Several factors affected performance. For one, SupeRx fully utilized the efficiencies of Kroger's drug and general merchandise procurement and distribution unit, Peyton's Inc. For another, it contributed to the company-wide cost containment program.

Additionally, sales were spurred by growing customer acceptance of SupeRx's drug-convenience store concept. SupeRx is adding a limited assortment of convenience foods to its larger stores, while in its new facilities and in remodels, as many as 1,000 grocery and perishable items are being offered in addition to the typical drug store selection.

Kroger Manufacturing

Aside from Kroger Food Stores, no operation of the company

In a modern SupeRx drug-convenience store, the traditional offering of drug and health-related products, plus the services of a complete pharmacy, are augmented by a limited selection of convenience food items, like bread and milk.

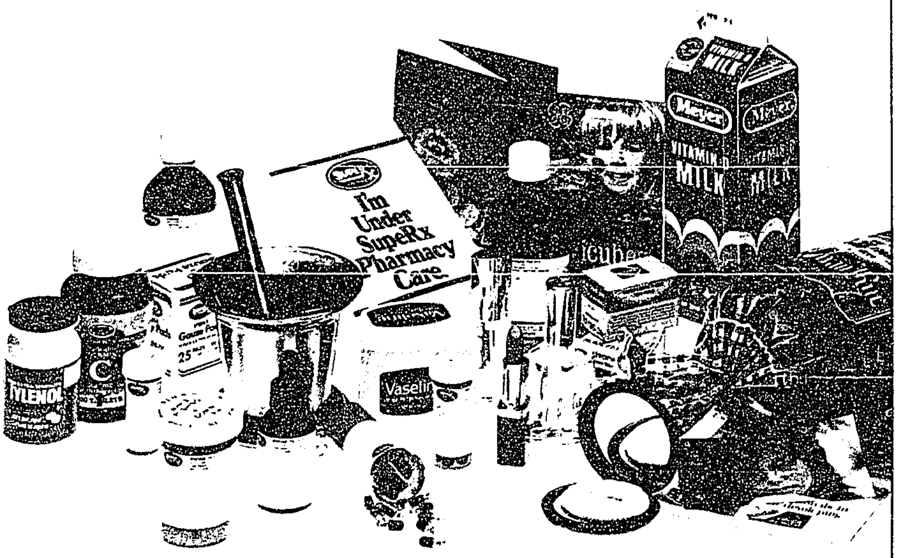
received as much management attention in 1984 as Kroger's manufacturing division.

Kroger Manufacturing sales in 1984 declined slightly, in part because its market shrank with the closing of a substantial number of Kroger Food Stores, but also because shoppers increasingly preferred national brand products.

To deal with this marketplace change, both in the short and long term, the role of Kroger Manufacturing within the company was modified during the year. In essence, this unit has been redirected to become more marketing oriented so that its products will compete with product lines made by national manufacturers.

The new role presents this unit with clear marketing and operating challenges. Products made in the company's 41 manufacturing facilities will compete with national brands for shelf and display space, as well as advertising. Kroger Manufacturing also is stepping up its efforts to sell its products outside the company, a market now accounting for about 15% of total manufacturing sales.

On the production side, the overall focus within the unit will be on improving the return on Manufacturing's existing assets. The goal is to trim production costs to a level at least equivalent with full-line food manufacturers. This is



being addressed with a top to bottom cost containment program within Manufacturing, and by a continuing assessment of products to determine which should continue to be Kroger-produced.

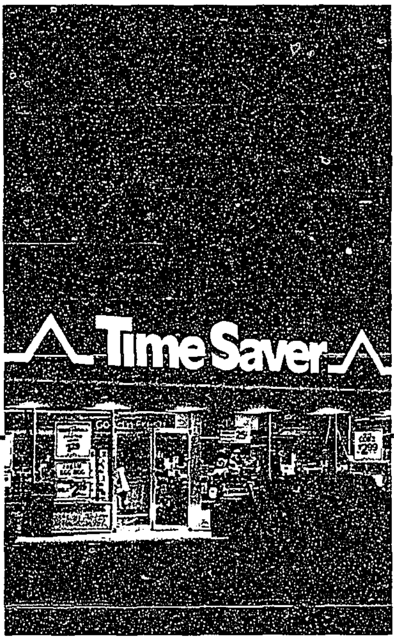
These changes have been accompanied by a number of management realignments designed to more fully integrate Kroger Manufacturing into the retail operations of the company. Richard M. Koster, formerly senior vice president in charge of Kroger's overall merchandising efforts, has taken over direction of Kroger Manufacturing.

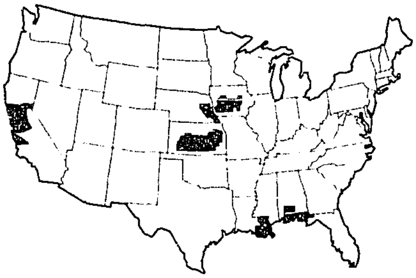
Wholesaling

Kroger's first venture into wholesaling appears to have gotten off to a firm start.

Our joint wholesaling partnership with Wetterau, Inc., began operations in Michigan in September. The partnership, Foodland Distributors, serves 71 Kroger Food Stores in Michigan and northern Ohio and 28 former Kroger stores now operated by independents.

While results are too preliminary to make lasting judgments, Foodland Distributors' goal





The 443 convenience stores operated by the company's Dillon Division represent a fast-growing segment of food retailing. Convenience stores under the Time Saver name are located in the New Orleans area; Quik Stop Markets are in northern California; and Kwik Shop operates in Kansas, Nebraska and Iowa. In addition, 86 Tom Thumb Food Stores in western Florida and southern Alabama were purchased during 1984. Self-service gasoline is available in approximately half of the stores.

of becoming a viable wholesaling operation in Michigan looks to be realistic and attainable.

1985 Outlook

Our results in 1984, although certainly gratifying, are much more significant for what they portend.

In 1984, the company strengthened itself in the fundamentals of the business. We improved the return on existing assets and implemented several changes designed to streamline management decision-making, on the one hand, and increase merchandising and operating flexibility, on the other. We also were able to scale down our cost structure.

These improvements provide Kroger with substantial leverage for 1985. With costs much better in line, with underproductive stores and support facilities eliminated from operations, and with a renewed sense of management vigor, the current year is one of real opportunity.

The external operating environment for 1985 should be favorable. In fact, conditions generally should equate with the last half of 1984, with employment rates stable or increasing, inflation low, and GNP growing modestly.

Due to our continuing emphasis on improving existing asset performance, capital spending again will be modest—approximately $300 million. For 1985, Kroger expects to open 48 new food stores, averaging nearly 47,000 square feet in size, and remodel another 146 stores. The majority of new stores will be combination food/drug stores. In convenience stores, the company expects to open 43 new outlets and remodel 46.

SupeRx Drug Stores plans to open 24 facilities in 1985 and remodel about the same number of existing stores.

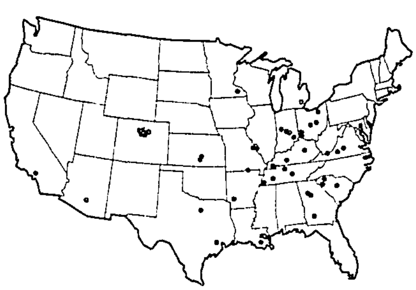
In a drug store-related development, Kroger announced in February, 1985, that it would acquire Hook Drugs, Inc., of Indianapolis. The company operates 301 drug stores and 14 home health care centers in Indiana, Illinois, Ohio and Kentucky.

Kroger Manufacturing will concentrate on fully utilizing existing capacity; it has no plans for new production facilities.

From a merchandising point of view, 1985 will, if anything, continue to demonstrate the company's increasing variety and flexibility.

Our experience with combination food and drug store formats, virtually all of which have been opened in the past six years, is encouraging. Because of their size, the variety of products available and their emphasis on in-store service, combination stores can generate much higher sales and

Familiar names in easy-to-recognize packages. These are typical of the national brand products which form the core of Kroger's food store sales.



Kroger operates 41 processing plants, including 12 bakeries, 13 dairies, and facilities for processing cheese, eggs, peanut butter, pet foods, film, ice, carbonated beverages, snack foods, preserves, salad dressings and other items. Other Kroger-label products are made by leading food manufacturing companies. The Kroger Technical Center develops new products and maintains quality standards of Kroger products.

profits. As a result, they are taking an ever larger portion of our capital budget.

However, not all markets or trade areas are suited to the combo store. As a result, we will continue to develop store facilities of differing sizes and formats to address the specific needs of the particular trade area.

Merchandise selection, promotional activity — even the store "look"— also will be more flexible to accommodate the wide variety of Kroger's many markets. This flexible approach will be supported by corporate advertising, such as the new "Feel the Difference" campaign, which emphasizes the key strengths of our stores' shopping appeal: convenience, value and service.

Corporate Responsibility

During 1984, The Kroger Co. continued to support its business operations with active and ongoing programs of corporate and personal involvement in hundreds of Kroger communities. The company perceives this to be an essential activity.

Commitment takes many forms. Employees in Nashville generated more than $250,000 in donations from the community, and immeasurable good will, in an effort to save the life of an infant suffering from a fatal liver disease. For this activity our Nashville regional office received the 1984 B.H. Kroger Award for Community Service.

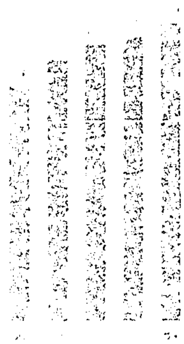
Other activities in other Kroger cities and towns paralleled the Nashville story. Usable food that for one reason or another can't be sold was collected and re-distributed to charitable food organizations. Company employees devoted thousands of hours of volunteer time for innumerable activities, including United Appeal, Big Brothers/Big Sisters, local Heart Association chapters, and many others.

For the full year, Kroger made contributions to non-profit causes totaling $1,915,461. About 60% of this total was given to United Way campaigns; the remainder went to a variety of civic, cultural and educational activities.

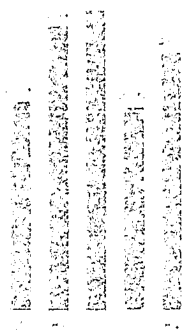
In addition to the formal contributions program, the various operating units of the company made product or cash contributions in support of many community undertakings. These contributions totaled $1,048,000.

Together, these activities represented a financial commitment of $2,963,461, or 1.12% of our pretax earnings. The median of charitable activities of a composite of U.S. corporations in 1983 also was 1.12%.

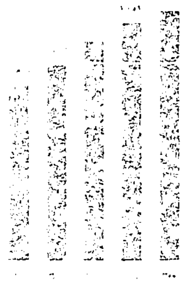
Sales
(Billions)



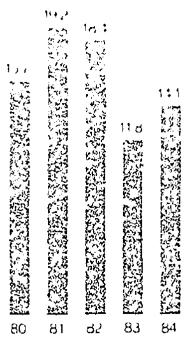
Earnings Per Share
(Dollars)



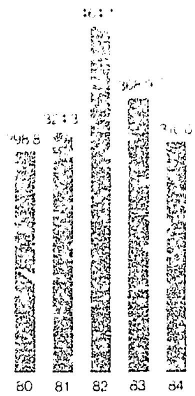
Dividends Per Share
of Common Stock
(Dollars)



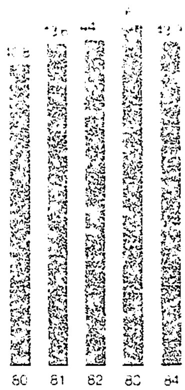
Return on Average
Shareowners' Equity
(Percent)



Capital Expenditures
(Millions)



Food Store
Square Footage
(Millions)



Our principal objective is to be a performance-proven leader in the distribution and merchandising of food, drugs and related products and services to the consumer.

- *We will serve customers, primarily through retail stores in the U.S., whenever doing so will provide a value to them and a profit opportunity for the company.*
- *We will invest in manufacturing and distribution facilities whenever this course will improve our profit potential and increase the value received by customers of company-owned or affiliated retail outlets.*
- *We will satisfy the needs of consumers as well as, or better than, the best of our competitors, and in so doing, we will grow as a company and meet the expectations of our employees and shareowners.*
- *We will encourage our employees to be active and responsible citizens in the communities in which we operate, and we will allocate resources for activities which enhance the quality of life for our customers, employees and the general public.*

Management's Responsibility for Financial Reporting

The consolidated financial statements of The Kroger Co. and Consolidated Subsidiary Companies and other financial information contained in this report were prepared by management, which is responsible for their integrity and completeness. These statements were prepared in conformity with generally accepted accounting principles and necessarily include some amounts that are based on management's best estimates and judgments.

The Company has, over the years, maintained a system of internal accounting controls to provide reasonable assurance that Company assets are adequately protected, and that transactions are executed in accordance with management's authorizations and are reflected accurately in the Company's books and records as a basis for the reliable preparation of the financial statements. The system of controls includes careful selection and training of financial management personnel, clearly defined limits of authority and division of responsibility, the dissemination of detailed formal accounting and business policies and procedures, and an extensive program of internal audit examinations to monitor the effectiveness of the system. The Company has distributed to key employees its policy requiring high moral, ethical and legal standards in the conduct of its business.

Coopers & Lybrand, independent certified public accountants, have examined the consolidated financial statements in accordance with generally accepted auditing standards. Their report on the consolidated financial statements appears on page 26.

The Board of Directors, acting through its Audit Committee comprised entirely of outside directors, oversees the fulfillment by management of its responsibilities in the preparation of financial statements and for financial control. The Committee recommends the selection of the Company's certified public accountants, reviews the scope and cost of the internal and external audit programs and meets formally at least three times per year with the internal and external auditors, providing them direct free access at these and other times.

AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The analysis of Company operations encompassing the years 1982, 1983, and 1984 should be considered in conjunction with the Consolidated Financial Statements and the Ten Year Summary.

Liquidity and Capital Resources

Cash provided from operations before working capital changes was $389.7 million in 1984. Inventories at current cost were intentionally increased at year-end to be better prepared for post-holiday business and were $124.7 million higher at year-end 1984 compared to 1983. Cash provided from current operations, including working capital changes, was $379.6 million in 1984 compared to $363.3 million in 1983 and $299.3 million in 1982.

Cash provided from current operations over the past three years totaled $1.04 billion and covered 91% of the $1.14 billion required for capital expenditures and 75% of the $1.40 billion required for capital expenditures and dividends. Capital expenditures totaled $310.0 million in 1984 which was a decrease from $368.9 million in 1983 and $464.4 million in 1982. New store activity during 1984 included 46 new supermarkets, 26 new drug stores and 99 new convenience stores including 86 Tom Thumb stores acquired in June of 1984. In 1985, capital expenditures will be approximately $300 million. Storing plans include approximately 48 supermarkets, 24 drug stores and 43 convenience stores. The Company will continue to finance expansion with internally generated cash flow. Long-term debt will be employed as required and short-term capital needs will be met with commercial paper.

Cash was generated again in 1984 from the disposition of underproductive assets, principally in western Pennsylvania and northeast Ohio. The net book value of fixed asset disposals was $78.7 million in 1984 compared to $59.1 million in 1983 and $53.4 million in 1982.

There were no major financing activities in 1984. Additions to long-term debt and obligations under capital leases totaled only $36.9 million compared to $178.9 million in 1983 and $247.3 million in 1982.

There were no short-term borrowings at year-end 1984. Short-term borrowings averaged $42.6 million in 1984 compared to $82.9 million in 1983 and $40.4 million in 1982.

Long-term debt and obligations under capital leases were reduced by $136.0 million in 1984 compared to $99.3 million in 1983 and $114.2 million in 1982. Future rent obligations under operating leases decreased $273 million in 1984.

On February 14, 1985 the Company and Hook Drugs, Inc. ("Hook") entered into an agreement which provides for the merger of Hook into a subsidiary of the Company. The Company will acquire Hook for cash and common stock of the Company. The merger is intended to be a tax-free reorganization for those shareholders receiving common stock, and is subject to the approval of the holders of a majority of Hook shares and certain other customary conditions. The acquisition price for Hook is $160 million. The Company is acquiring its own stock in the open market, and intends to reissue such shares in connection with the merger.

At December 29, 1984, the Company had available a revolving credit aggregating $250 million against which it may obtain interim loans until March, 1989. At the Company's request, the interim loans may be converted into term loans payable over six years.

Because of lower capital expenditure levels, store closings and increasing LIFO reserves, working capital requirements have been decreasing. Working capital at December 29, 1984, was $276.5 million compared with $339.7 million at December 31, 1983 and $368.3 million at January 1, 1983. The current ratio was 1.19 to 1 compared to 1.26 to 1 at year-end 1983 and 1.30 to 1 at year-end 1982. The LIFO inventory reserve at December 29, 1984 was $217.6 million compared to $187.8 million at year-end 1983 and $165.3 million at year-end 1982.

Debt obligations, as a percentage of long-term capitalization, declined to 40.4% of long-term capitalization in 1984 from 45.0% in 1983 and 42.3% in 1982. Pre-tax coverage of interest and rents improved to 1.84 times in 1984 compared to 1.71 times in 1983 and 2.11 times in 1982.

	Percent of Long-Term Capitalization		
	1984	1983	1982
Debt Obligations	**30.0%**	34.1%	32.0%
Capitalized Lease Obligations	**10.4**	10.9	10.3
Total	**40.4%**	45.0%	42.3%

Results of Operations

Consolidated sales of $15.9 billion were 4.5% ahead of 1983 despite the closing of 156 supermarkets during the year.

Consolidated Sales (In Millions)

	1984		1983		1982	
	Amt.	Chg.	Amt.	Chg.	Amt.	Chg.
Food Stores	**$14,473**	**+ 3.9%**	$13,931	+ 2.6%	$13,574	+ 5.5%
Drug Stores	**859**	**+ 8.8%**	789	+10.2%	716	+ 6.9%
Convenience Stores	**311**	**+19.6%**	260	+ 3.2%	252	+ .8%
Other	**280**	**+ 9.4%**	256	+16.4%	220	+24.3%
Total	**$15,923**	**+ 4.5%**	$15,236	+ 3.2%	$14,762	+ 5.8%

Factors influencing the food store sales increase in 1984 versus 1983 included moderate inflation, increased percentages of non-food sales, a 1.4% decrease in average square footage, and a net reduction in store count of 110 stores. Identical food store sales increased 4.2%.

Total drug store sales increased 8.8% over 1983 while identical store sales increased 7.2%. The sales increase compared to 1983 was also influenced by moderate inflation and a 1.4% increase in average square footage.

Merchandise costs, including warehousing and transportation, were steady at 76.5% of sales compared to 76.5% in 1983 and 76.8% in 1982. The LIFO charge in 1984 was $29.8 million compared to $22.5 million in 1983 and $22.3 million in 1982. The drug store division adopted the LIFO method in 1984 accounting for $5.5 million of the $7.3 million increase over 1983.

The reduction of operating, general and administrative expenses as a percent of sales strongly influenced the improvement in operating profit. The expense rate was 18.8% of sales in 1984 compared to 19.1% in 1983 and 18.6% in 1982.

Operating profits of Kroger Food Stores increased dramatically and were more than double the depressed 1983 level. Pre-tax operating profits of the SupeRx drug store division were $33.9 million on a FIFO basis compared to $27.2 million in 1983 and $15.2 million in 1982; however, the first time LIFO charge reduced the 1984 operating profit to $28.4 million. Operating profits of the Dillon Companies were also substantially ahead of the 1983 level, increasing by 24%.

Net Earnings

Net earnings improved to $156.6 million in 1984 from $127.1 million in 1983 but were below the $192.1 million level of 1982.

The average number of primary shares outstanding has declined from 46.2 million shares in 1982 to 45.9 million in 1983 and 44.9 million in 1984. The reduction in number of shares outstanding improved net earnings per share by $.08 in 1984 compared to 1983 and $.02 in 1983 compared to 1982. The effective tax rate increased to 41.0% in 1984 from 40.0% in 1983 and 34.0% in 1982. The principal cause of the higher tax rate is lower tax credits resulting from the lower level of capital expenditures.

The Company's reported sales, earnings, shareowners' equity and other pertinent financial data have been affected by inflation in recent years. An estimation and evaluation of the effect of inflation, as defined by Statement of Financial Accounting Standards No. 33, Financial Reporting and Changing Prices, follows on page 27.

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(In thousands of dollars)

	December 29, 1984	December 31, 1983
ASSETS		
Current assets		
Cash and temporary cash investments	**$ 163,209**	$ 142,106
Receivables	**204,062**	156,359
Inventories:		
FIFO cost	**1,463,626**	1,338,939
Less LIFO reserve	**(217,641)**	(187,808)
	1,245,985	1,151,131
Property held for resale	**10,724**	105,075
Prepaid and other current assets	**116,049**	110,188
Total current assets	**1,740,029**	1,664,859
Notes receivable	**35,788**	29,427
Property, plant and equipment		
Land	**134,731**	97,662
Buildings and land improvements	**461,037**	387,588
Equipment	**1,533,050**	1,469,541
Leaseholds and leasehold improvements	**466,984**	433,993
Leased property under capital leases	**257,586**	269,489
	2,853,388	2,658,273
Allowance for depreciation and amortization	**(1,006,952)**	(888,934)
Property, plant and equipment, net	**1,846,436**	1,769,339
Investments and other assets	**65,073**	66,188
Total Assets	**$3,687,326**	$3,529,813

The accompanying notes are an integral part of the consolidated financial statements.

	December 29, 1984	December 31, 1983
LIABILITIES		
Current liabilities		
Current portion of long-term debt	$ 57,233	$ 6,084
Current portion of obligations under capital leases	5,601	6,057
Accounts payable	906,758	842,155
Other current liabilities	424,132	418,600
Accrued income taxes	69,783	52,262
Total current liabilities	1,463,507	1,325,158
Long-term debt	577,842	665,386
Obligations under capital leases	200,815	212,406
Deferred income taxes	274,576	232,201
Employees' benefit fund	21,810	21,810
Total Liabilities	2,538,550	2,456,961
SHAREOWNERS' EQUITY		
Common capital stock, par $1, at stated value Issued: 1984 - 48,244,537 shares 1983 - 47,392,143 shares	381,696	357,408
Accumulated earnings	887,606	820,944
Common stock in treasury, at cost 1984 - 3,158,754 shares 1983 - 2,647,451 shares	(114,952)	(99,203)
Net unrealized loss on marketable equity securities	(5,574)	(6,297)
Total Shareowners' Equity	1,148,776	1,072,852
Total Liabilities and Shareowners' Equity	$3,687,326	$3,529,813

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AND ACCUMULATED EARNINGS

Years Ended December 29, 1984, December 31, 1983 and January 1, 1983
(In thousands of dollars, except per share amounts)

	1984 (52 Weeks)	1983 (52 Weeks)	1982 (52 Weeks)
Sales	**$15,922,891**	$15,236,013	$14,761,764
Costs and expenses:			
Merchandise costs, including warehousing and transportation	**12,175,606**	11,656,585	11,343,284
Operating, general and administrative	**2,998,366**	2,907,339	2,744,998
Rent	**218,857**	208,394	192,114
Depreciation and amortization	**190,664**	179,660	152,052
Dividend and interest income	**(23,173)**	(18,231)	(31,723)
Interest expense	**97,208**	90,297	69,819
Total	**15,657,528**	15,024,044	14,470,544
Earnings before taxes based on income	**265,363**	211,969	291,220
Taxes based on income	**108,730**	84,890	99,096
Net earnings	**$ 156,633**	$ 127,079	$ 192,124
Accumulated earnings			
Beginning of year	**$ 820,944**	$ 792,641	$ 701,994
Net earnings	**156,633**	127,079	192,124
Cash dividends on common stock	**(89,971)**	(85,188)	(73,549)
Cash dividends on preferred stock		(2,250)	(4,500)
Reacquisition of preferred stock		(11,338)	
Stock dividends (Dillon)			(23,428)
End of year	**$ 887,606**	$ 820,944	$ 792,641
Earnings per share			
Primary	**$3.49**	$2.77	$4.15
Fully diluted	**$3.49**	$2.76	$4.05
Cash dividends per common share	**$2.00**	$1.91	$1.76

The accompanying notes are an integral part of the consolidated financial statements.

IN FINANCIAL POSITION

Years Ended December 29, 1984, December 31, 1983 and January 1, 1983
(In thousands of dollars)

	1984 (52 Weeks)	1983 (52 Weeks)	1982 (52 Weeks)
Cash Provided (Used) From Operations			
Net earnings	**$156,633**	$127,079	$192,124
Charges not involving cash:			
Depreciation and amortization	**190,664**	179,660	152,052
Provision for deferred income taxes	**42,375**	55,366	19,771
Write-off of cost of investment in excess of equity in net assets			12,294
Earnings and non-cash charges	**389,672**	362,105	376,241
Increase in current cost of inventory	**(124,687)**	(64,851)	(179,267)
LIFO charge	**29,833**	22,506	22,253
Increase in other current assets	**(53,564)**	(45,087)	(38,215)
Increase in current liabilities	**138,349**	88,651	118,284
Cash provided from operations	**379,603**	363,324	299,296
Cash Provided (Used) Through Financing Activities			
Cash dividends	**(89,971)**	(87,438)	(78,049)
Common stock issued	**23,575**	6,141	62,911
Common stock reacquired	**(15,194)**		(95,882)
Preferred stock reacquired		(61,338)	
Additions to long-term debt and obligations under capital leases	**36,892**	178,871	247,338
Reductions of long-term debt and obligations under capital leases	**(136,027)**	(99,281)	(114,153)
Net book value of fixed asset disposals	**78,654**	59,054	53,415
Capital expenditures	**(310,029)**	(368,895)	(464,380)
Decrease (increase) in property held for resale	**94,351**	(34,742)	(39,744)
Increase in leased property under capital leases	**(7,622)**	(25,800)	(13,367)
Other changes, net	**(33,129)**	8,016	(10,928)
Cash used through financing activities	**(358,500)**	(425,412)	(452,839)
Increase (Decrease) in Cash and Temporary Cash Investments	**21,103**	(62,088)	(153,543)
Cash and Temporary Cash Investments:			
Beginning of Year	**142,106**	204,194	357,737
End of Year	**$163,209**	$142,106	$204,194

The accompanying notes are an integral part of the consolidated financial statements.

All dollar amounts are in thousands except per share amounts.

Accounting Policies

The following is a summary of certain accounting policies followed in preparing the financial statements.

Principles of Consolidation

The consolidated financial statements include the Company and all of its subsidiaries except a wholly-owned life insurance subsidiary which is included on the equity basis. Partially-owned affiliated companies are included in the financial statements on the equity basis. Certain amounts in the balance sheet and statement of changes in financial position for prior years have been reclassified to conform to the 1984 presentation.

Inventories

Inventories are stated at the lower of cost (principally LIFO) or market. Approximately 87% of inventories for 1984 and 75% of inventories for 1983 were valued using the LIFO method. The application of the LIFO method to the Company's Drug Store inventories, beginning in 1984, had no material effect on the financial statements. Cost for the balance of the inventories is determined by the FIFO method of inventory valuation.

Property Held for Resale

Property held for resale represents the cost of certain land and buildings held by the Company for sale during the next year.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation and amortization, which include the amortization of assets recorded under capital leases, are computed principally on the straight-line basis. Buildings and land improvements are depreciated based on lives varying from ten to forty years and equipment based on lives varying from three to fifteen years. Leasehold improvements are amortized over their useful lives which generally approximate twelve and one-half years. When properties are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts with any resulting gain or loss reflected in earnings. Maintenance and repair costs are expensed in the year incurred.

Deferred Income Taxes and Investment Tax Credits

Deferred income taxes consist primarily of the amount of tax applicable to the excess of depreciation for tax purposes over depreciation used for financial reporting purposes.

Investment tax credits are included as reductions of income tax expense in the years in which the credits arise.

Other Current Liabilities

Other current liabilities as of December 29, 1984 and December 31, 1983 consists of:

	1984	1983
Salaries and wages	**$167,494**	$162,816
Taxes, other than income taxes	**85,609**	93,145
Other	**171,029**	162,639
	$424,132	$418,600

Debt Obligations

Long-term debt as of December 29, 1984 and December 31, 1983 consists of:

	1984	1983
14⅝% notes maturing in 1991	**$ 44,825**	$ 50,000
12⅝% sinking fund debentures maturing in 2005, with annual payments of $2,500 required from 1992 through 2004	**37,600**	50,000
9½% two-year extendible notes due in 1985	**50,000**	50,000
9% sinking fund debentures maturing in 1995, with annual payments of $2,500 required from 1988 through 1995	**19,780**	23,649
8.7% sinking fund debentures maturing in 1998, with annual payments of $3,000 required from 1989 through 1998	**28,882**	40,514
8½% sinking fund debentures maturing in 2001, with annual payments of $2,500 required from 1990 through 2001	**26,917**	38,717
5⅝% to 14¼% industrial revenue bonds, with annual payments due in varying amounts through 2022	**339,626**	330,447
5⅝% to 12⅞% mortgages with annual payments due in varying amounts through 2010	**61,612**	60,935
4½% to 12½% notes, with annual payments due in varying amounts through 2004	**25,833**	27,208
Total debt	**635,075**	671,470
Less amount due within one year	**(57,233)**	(6,084)
Total long-term debt	**$577,842**	$665,386

The aggregate annual maturities and required payments of long-term debt for the five years subsequent to 1984 are:

1985	$57,233
1986	$13,238
1987	$24,946
1988	$25,882
1989	$22,547

Certain industrial revenue bonds and mortgage notes payable are collateralized by property, plant and equipment.

Under certain of the loan agreements, payments of cash dividends are limited. Under the most limiting agreement, accumulated earnings were unrestricted in the amount of $299,000 at December 29, 1984.

The Company periodically engages in short-term borrowing. Short-term borrowing for the three years ended December 29, 1984 was:

	1984	1983	1982
Weighted average for the year	**$ 42,613**	$ 82,859	$ 40,384
Highest level outstanding during the year	**$108,942**	$156,963	$176,399
Weighted average interest rate	**10.09%**	9.03%	10.03%

At December 29, 1984, the Company had available a revolving credit aggregating $250,000 against which it may obtain interim loans until March, 1989. The interest rate on the interim loans would vary between The First National Bank of Chicago corporate base rate, and that rate plus ¾% per annum. The interim loans may be converted into term loans payable over six years. No amounts have been borrowed under this agreement.

Interest costs capitalized in 1984, 1983 and 1982 amounted to $2,868, $7,069 and $8,584, respectively.

Leases

The Company operates principally in leased premises. Lease terms generally range from 10 to 25 years with options of renewal for additional periods. Options provide in some cases for reduced rentals and/or the right to purchase. Certain of the leases provide for contingent payments based upon a percent of sales.

Rent expense (under operating leases) consists of:

	1984	1983	1982
Minimum rentals, net of minor sublease rentals	**$198,944**	$190,822	$173,034
Contingent payments	**19,913**	17,572	19,080
Total	**$218,857**	$208,394	$192,114

Assets recorded under capital leases consist of:

	1984	1983
Distribution and manufacturing facilities	**$114,389**	$115,944
Store facilities	**143,197**	153,545
Less accumulated amortization	**(80,037)**	(78,498)
	$177,549	$190,991

Minimum annual rentals, net of subleased rentals under operating leases of $400,872, for the five years subsequent to 1984 and in the aggregate are:

	Capital Leases	Operating Leases
1985	**$ 29,250**	**$ 198,478**
1986	**28,472**	**194,549**
1987	**28,383**	**188,211**
1988	**28,234**	**183,706**
1989	**28,179**	**182,649**
1990 and thereafter	**376,047**	**1,966,165**
	518,565	**$2,913,758**
Less estimated executory costs included in capital leases	**(35,149)**	
Net minimum lease payments under capital leases	**483,416**	
Less amount representing interest	**(277,000)**	
Present value of net minimum lease payments under capital leases	**$206,416**	

Preferred Stock

The Company has authorized 5,000,000 shares of voting cumulative preferred stock, 4,500,000 of which are currently available for issuance. The stock has a par value of $100 and is issuable in series. None is outstanding at December 29, 1984.

During 1983, the Company reacquired the outstanding preferred stock. The excess of cost over par value of the shares reacquired, $11,338, was charged to accumulated earnings.

Common Stock

The Company has authorized 125,000,000 shares of $1 par common capital stock. For the three years ended December 29, 1984, changes in common stock were:

	Issued		In Treasury	
	Shares	Amount	Shares	Amount
January 2, 1982	43,920,977	$264,407	287,873	$ 4,509
Exercise of stock options	421,662	5,710	31,202	995
Stock issued in exchange for debt	205,966	5,939		
Stock issued for conversion of debentures	1,710,000	50,498		
Common stock received for assets			2,398,702	95,882
Stock contributed to employee stock ownership plan and others	10,856	675	(81,953)	(2,637)
Common stock retired (Dillon)	(94,697)	(2,335)		
Tax benefit from exercise of non-qualified stock options		1,498		
Dividends reinvested under stock purchase plan	23,267	764		
Stock dividend (Dillon)	936,634	23,472		
January 1, 1983	47,134,665	$350,628	2,635,824	$98,749

	Issued		In Treasury	
	Shares	Amount	Shares	Amount
January 1, 1983	47,134,665	$350,628	2,635,824	$98,749
Exercise of stock options	148,096	2,142	11,627	454
Stock issued in exchange for debt	76,630	2,792		
Tax benefit from exercise of non-qualified stock options		639		
Dividends reinvested under stock purchase plan	32,752	1,207		
December 31, 1983	**47,392,143**	**357,408**	**2,647,451**	**99,203**
Exercise of stock options	**197,666**	**3,263**	**16,303**	**555**
Stock issued in exchange for debt	**607,914**	**18,741**		
Common stock reacquired			**495,000**	**15,194**
Tax benefit from exercise of non-qualified stock options		**713**		
Dividends reinvested under stock purchase plan	**46,814**	**1,571**		
December 29, 1984	**48,244,537**	**$381,696**	**3,158,754**	**$114,952**

Stock Option Plans

At December 29, 1984, options were outstanding to purchase 1,340,414 shares of common stock under the 1969, 1976, 1981 and 1982 (Dillon) Stock Option Plans (of which options on 834,731 shares were exercisable at that date) at prices ranging from $8.63 to $42.44 a share. In addition to cash payments, the plans provide for the exercise of options by exchanging issued shares of stock of the Company. Each option outstanding was granted at an option price equal to the fair market value of the stock at the date of grant. No further options will be granted under the 1969 and 1982 Plans. Options may be granted under the 1976 and 1981 Plans until 1986 and 1991, respectively. At December 31, 1983, shares of common stock available for future options under the 1976 and 1981 Plans were 8,763 and 66,800 shares, respectively. At December 29, 1984, shares of common stock available for future options under the 1976 and 1981 Plans were 11,213 and 4,550 shares, respectively.

Changes in options outstanding under the Stock Option Plans of the Company were:

	Shares Subject To Option	Option Price Range Per Share
Outstanding, January 2, 1982	1,340,033	$ 7.78—$25 44
Granted	313,180	$24.93—$42.44
Exercised	(421,662)	$ 7.78—$26.81
Cancelled or expired	(12,451)	$ 7.78—$25.44
Outstanding, January 1, 1983	1,219,100	$ 7.78—$42.44
Granted	429,500	$36.06—$42.19
Exercised	(148,096)	$ 7.78—$36.38
Cancelled or expired	(12,150)	$19.75—$36.38
Outstanding, December 31, 1983	**1,488,354**	**$ 7.78—$42.44**
Granted	**104,800**	**$30.50—$38.13**
Exercised	**(197,666)**	**$ 7.78—$31.38**
Cancelled or expired	**(55,074)**	**$ 7.91—$40.44**
Outstanding, December 29, 1984	**1,340,414**	**$ 8.63—$42.44**

The Company has a Stock Appreciation Rights Plan available to certain officers. In general, the eligible optionees are permitted to surrender the related option and receive cash and shares of the Company's common stock having a value equal to the appreciation on the shares subject to the option. At December 29, 1984, no Stock Appreciation Rights were outstanding.

Taxes Based on Income

The provision for taxes based on income consists of:

Federal:	**1984**	1983	1982
Current	**$ 47,455**	$ 10,604	$ 36,912
Deferred	**42,375**	55,366	19,771
	89,830	65,970	56,683
State and local-current	**18,900**	18,920	18,547
Charges in lieu of federal income taxes			23,866
Total	**$108,730**	$ 84,890	$ 99,096

Investment and other tax credits reduced the tax provision by $17,386 in 1984, $25,163 in 1983 and $31,883 in 1982.

Charges in lieu of federal income taxes represent estimated amounts payable under a tax allocation agreement which ceased in 1983.

A reconciliation of the statutory federal rate and the effective rate is:

	1984	1983	1982
Statutory rate	**46.0%**	46.0%	46.0%
State income taxes, net of federal tax benefit	**3.8**	4.8	3.5
Investment and other tax credits	**(6.6)**	(11.9)	(11.0)
Write-off of cost of investment in excess of equity in net assets			2.0
Capital gains	**(2.7)**		(4.5)
Other, net	**.5**	1.1	(2.0)
Effective rate	**41.0%**	40.0%	34.0%

Deferred income taxes included in the Consolidated Statement of Earnings and Accumulated Earnings represent the tax effect of amounts expensed (included in earnings) for tax purposes in excess of amounts used for financial reporting, and consist of:

	1984	1983	1982
Depreciation	**$40,282**	$41,467	$31,890
Other	**2,093**	13,899	(12,119)
	$42,375	$55,366	$19,771

Pension Plans

The Company has various non-contributory retirement plans for eligible employees. Certain plans, which were previously unfunded, are being funded over periods ranging from twenty-two to thirty-one years as of December 29, 1984. The Company also contributes to multi-employer plans jointly administered by management and union representatives. The total pension expense for 1984, 1983 and 1982 was $113,098, $118,895 and $117,698, respectively. The Company's policy is to fund pension expense as accrued. Past service costs of the Company's plans are amortized over periods ranging from thirty to forty years.

During 1984, several actuarial assumptions used in calculating pension expense for certain Company plans were changed. The most significant changes were to change the salary scale from rates which varied by attained age to an assumed rate per year for all ages and to change the assumed annual investment rate of return from 7½% to 9%. The net effect of these changes was to reduce 1984 pension expense by $6,862.

Accumulated plan benefits and plan net assets for the Company administered plans were:

	January 1, 1984		January 1, 1983	
	(a)	(b)	(a)	(b)
Actuarial present value of accumulated plan benefits	**$314,419**	**$215,872**	$349,357	$249,841
Net assets available for benefits	**$332,040**	**$332,040**	$299,119	$299,119

(a) These amounts reflect the actuarial present value of accumulated plan benefits used to determine pension expense for the respective years and assume an annual increase in salaries.

(b) In accordance with Financial Accounting Standards Board Statement No. 36, Disclosure of Pension Information, these actuarial present values of accumulated plan benefits do not include any assumption of salary increases prior to retirement. Of the totals at January 1, 1984 and January 1, 1983, the vested portion is $193,496 and $228,182, respectively. Internal Revenue Service Ruling 85-6 in January, 1985 would cause a significantly higher amount of actuarial present value of accumulated plan benefits to be established, as a result of early retirement benefits which would be realized, if the plans were terminated.

The weighted average assumed rate of return used in determining the actuarial present value of accumulated plan benefits for certain Company plans was increased effective January 1, 1984 from 7½% to 9% resulting in a decrease in the actuarial present value of accumulated plan benefits of $42,762.

Information on the actuarial present value of accumulated plan benefits and net assets available for benefits relating to the multi-employer plans is not available.

Postretirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the Company provides certain health care and life insurance benefits for retired employees. The majority of the Company's employees may become eligible for those benefits if they reach normal retirement age while employed by the Company. The cost of retiree health care and life insurance benefits is recognized as expense as claims or premiums are paid. For 1984, the combined cost for those benefits was $2,114.

Earnings Per Share

In 1984, earnings per share is based on the weighted average number of common shares outstanding. The effect of common stock equivalents is not significant. In 1983 and 1982, primary and fully diluted earnings per share include the effect of dilutive common stock equivalents, including stock options and the Company's convertible preferred stock. Fully diluted earnings per share in 1982 also includes the effect of the Company's convertible debentures and the elimination of interest expense, net of income tax effect, applicable to the convertible debentures.

The average number of shares used to compute earnings per share is:

	Primary	Fully Diluted
1984	**44,933**	**44,933**
1983	45,869	45,970
1982	46,246	47,951

Store Closing Program

During 1982, the Company adopted a plan to close approximately 140 stores by the end of 1983 as part of the Company's continuing review of underproductive assets. Net earnings for 1982 included a gain of $14,200 or $.30 per share resulting from the actual and anticipated proceeds from the disposal of these properties offset by the net book value of assets sold or written-off and the known and anticipated operating losses and closing costs associated with the properties included in the plan.

Proceeds received in connection with the disposal of certain stores in 1982 included 1,656,309 shares of the Company's outstanding common stock valued at $66,599. An additional 742,393 shares of common stock were purchased by the Company out of additional proceeds from the store closing program.

Additional store closings occurred in 1984. Net earnings decreased $12.3 million, or $.27 per share due to the current and estimated future cost of store closings and the disposition of the properties.

Quarterly Data (Unaudited)

Quarterly sales, merchandise costs (including warehousing and transportation), net earnings and earnings per share for 1984 and 1983 were:

Quarter	Sales In Millions		Merchandise Costs In Millions	
	1984	1983	**1984**	1983
1st (12 Weeks)	**$ 3,633**	$ 3,386	**$ 2,787**	$ 2,585
2nd (12 Weeks)	**3,796**	3,567	**2,886**	2,723
3rd (16 Weeks)	**4,623**	4,505	**3,549**	3,454
4th (12 Weeks)	**3,871**	3,778	**2,954**	2,895
Total	**$15,923**	$15,236	**$12,176**	$11,657

Quarter	Net Earnings In Millions		Net Earnings Per Share	
	1984	1983	**1984**	1983
1st (12 Weeks)	**$ 18.8**	$ 21.5	**$ .42**	$ .46
2nd (12 Weeks)	**43.2**	35.4	**.96**	.76
3rd (16 Weeks)	**38.6**	28.5	**.86**	.62
4th (12 Weeks)	**56.0**	41.7	**1.25**	.93
Total	**$156.6**	$127.1	**$3.49**	$2.76

Net earnings increased $2,172 (5¢ per share) and $3,726 (8¢ per share), in the first and third quarters of 1984, respectively, as a result of the retirement of certain debentures. Net earnings decreased $10,000 (22¢ per share) in the second quarter and $2,300 (5¢ per share) in the fourth quarter of 1984 due to expenses related to store closings. Net earnings decreased $6,468 (14¢ per share) in the first quarter of 1983 due to fees and expenses associated with the merger with Dillon Companies, Inc. Net earnings increased $4,965 (11¢ per share) in the fourth quarter of 1983 resulting from an adjustment to conform certain accounting practices of various divisions of the Company.

Quarter	Common Stock Price Range 1984		1983	
	High	**Low**	High	Low
1st	**37¾**	**29⅝**	42⅞	34⅞
2nd	**33⅞**	**29⅛**	42⅞	35¾
3rd	**39¼**	**32⅛**	42¾	34½
4th	**39½**	**36**	38⅝	33¾

Dividends Paid Per Share of Common Stock

Date Paid	**1984**	1983
March 1	**$ .50**	$ .47
June 1	**.50**	.47
September 1	**.50**	.47
December 1	**.50**	.50

To the Shareowners and Board of Directors
The Kroger Co.

We have examined the consolidated balance sheets of The Kroger Co. and Consolidated Subsidiary Companies as of December 29, 1984 and December 31, 1983, and the related consolidated statements of earnings and accumulated earnings and changes in financial position for the years ended December 29, 1984, December 31, 1983 and January 1, 1983. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the consolidated financial position of The Kroger Co. and Consolidated Subsidiary Companies as of December 29, 1984 and December 31, 1983, and the consolidated results of their operations and the changes in their financial position for the years ended December 29, 1984, December 31, 1983 and January 1, 1983, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand

Coopers & Lybrand
Cincinnati, Ohio
February 22, 1985

In an effort to produce financial information that discloses the effects of inflation, the Financial Accounting Standards Board (FASB) issued Statement No. 33, Financial Reporting and Changing Prices, which requires companies to explain the effect of inflationary factors on their operations by adjusting historical financial information.

This information on a current cost method attempts to reflect the changes in prices of the resources employed specifically in our operations. This method involves the use of assumptions, approximations and estimates. The results should not be viewed as precise measurements of the effects of inflation.

Earnings derived under this method include adjustments to merchandise costs and depreciation and amortization expense for inflationary factors. The effects of inflation on merchandise costs have been recognized in the historical financial statements, to some extent, due to the use of the LIFO method of inventory valuation.

The accompanying statement of earnings and five-year comparison of selected financial data were prepared to reflect those inflationary factors due to increases in the specific costs of merchandise and depreciation and amortization and their related assets. Amounts prior to 1984 have been adjusted to average 1984 dollars by use of the CPI-U.

The restated net assets result in an indicated increase in shareowners' equity. The gain from decline in purchasing power of net amounts owed is primarily attributable to the debt which has been used to finance inventories and capital expenditures. During a period of inflation, holders of monetary assets suffer an unrealized loss of general purchasing power, while holders of monetary liabilities experience an unrealized gain.

Adjusted net income is lower than reported in the primary financial statements. Taxation of earnings under present tax law reduces the amount of earnings available to support future business growth because changing prices adjustments are not deductible for income tax purposes. The effects of the higher taxation of earnings are demonstrated in the effective tax rates shown on the supplementary income statement.

ADJUSTED FOR CHANGING PRICES

For the year ended December 29, 1984 (52 weeks) (In thousands of dollars)

	As Reported In The Primary Statements (Historical Costs)	Adjusted For Changes In Specific Prices (1984 Current Costs)
Sales	$15,923,000	$15,923,000
Costs and expenses:		
Merchandise costs, including warehousing and transportation	12,176,000	12,176,000
Operating, general and administrative	2,998,000	2,998,000
Rent	219,000	219,000
Depreciation and amortization	191,000	227,000
Dividend and interest income	(23,000)	(23,000)
Interest expense	97,000	97,000
Total	15,658,000	15,694,000
Earnings before taxes based on income	265,000	229,000
Taxes based on income	108,000	108,000
Net Earnings	$ 157,000	$ 121,000
Effective tax rate — taxes based on income	41.0%	47.2%
Gain from decline in purchasing power of net amounts owed		$ 83,000
Increase in specific prices of property, plant and equipment and inventories		$ 71,000
Less effect of increase in general prices		134,000
Excess of increase in general prices over increase in specific prices		$ (63,000)

At December 29, 1984 specific prices of inventories totaled $1,464,000 and specific prices of property, plant and equipment, net of accumulated depreciation, totaled $2,238,000. No adjustment is made to merchandise costs, including warehousing and transportation, in the supplemental income statement due to the Company's use of the LIFO method of accounting for approximately 87% of its inventories.

ADJUSTED FOR EFFECTS OF CHANGING PRICES

(In thousands of average 1984 dollars, except per share amounts)

	1984	1983	1982	1981	1980(a)
Sales	**$15,923,000**	15,884,000	15,885,000	15,941,000	15,903,000
Current Cost Data:					
Earnings from continuing operations	**$ 121,000**	78,000	146,000	129,000	71,000
Primary earnings per share from continuing operations	**$ 2.68**	1.71	3.16	2.88	1.61
Net assets at year-end	**$ 1,733,000**	1,799,000	1,909,000	2,051,000	1,940,000
Excess of increase in general prices over increase or decrease in specific prices	**$ (63,000)**	(70,000)	(163,000)	(114,000)	16,000
General Information:					
Gain from decline in purchasing power of net amounts owed	**$ 83,000**	77,000	66,000	138,000	179,000
Dividends per share	**$ 2.00**	1.99	1.90	1.79	1.75
Market price per share at year-end	**$ 38½**	37⅞	41½	28⅝	26⅛
Average consumer price index	**311.1**	298.4	289.1	272.4	246.8

(a) Fifty-three (53) weeks

NOTES TO SUPPLEMENTARY DATA ON CHANGE IN PRICES

Accounting Policies
The supplementary data on changing prices is based upon the historical financial information as reported in the primary financial statements adjusted for the changes in specific prices relating to property, plant and equipment and inventories.

Depreciation expense was calculated using the same methods and rates of depreciation as used in the historical financial statements.

Income tax expense has not been modified for any timing differences, allocations or adjustments that may result from applying the different methods in preparing the supplementary data.

No attempt has been made to calculate the benefit derived from additional realization of selling price increases necessitated by a higher level of cost of operations resulting from the application of current cost adjustments to the original historical cost of property, plant and equipment and inventories.

Current Cost
The current cost of inventories and merchandise costs represents the cost of purchasing the goods at year-end prices for inventory and prices in effect at date of sale for merchandise costs. Merchandise costs for 1984 have not been adjusted due to the use of the LIFO method for 87% of total inventories.

The current cost of property, plant and equipment and the related depreciation expense are estimates of what the Company's existing assets would cost at the respective balance sheet dates. The amounts for prior years have been adjusted to average 1984 dollars based on the CPI-U. Several methods, including indexation, direct pricing and application of square footage building and equipment costs based upon current merchandising and facility concepts, were used in estimating these amounts. These values represent the estimated current costs of existing assets and do not consider technological improvements and efficiencies associated with the normal replacement of productive capacity.

	1984	1983	1982
OPERATIONS (In thousands of dollars, except per common share amounts)			
Sales	$15,922,891	15,236,013	14,761,764
Earnings from continuing operations before taxes based on income	$ 265,363	211,969	291,220
Taxes based on income	$ 108,730	84,890	99,096
Net earnings from continuing operations	$ 156,633	127,079	192,124
Per share:			
Earnings from continuing operations	$ 3.49	2.76	4.05
Dividends on common stock	$ 2.00	1.91	1.76
BALANCE SHEET STATISTICS (In thousands of dollars, except per common share amounts)			
Inventories	$ 1,245,985	1,151,131	1,108,786
Working capital	$ 276,522	339,701	368,266
Property, plant and equipment, net	$ 1,846,436	1,769,339	1,610,693
Total assets	$ 3,687,326	3,529,813	3,319,699
Long-term debt	$ 577,842	665,386	604,007
Obligations under capital leases	$ 200,815	212,406	194,195
Shareowners' equity	$ 1,148,776	1,072,852	1,086,345
Per share	$ 25.48	23.98	23.29
OTHER STATISTICS (In thousands of dollars, except stock prices)			
Cash provided from operations	$ 379,603	363,324	299,296
Capital expenditures	$ 310,029	368,895	464,380
Rent	$ 218,857	208,394	192,114
Interest expense	$ 97,208	90,297	69,819
Common stock price range	$ 29⅛-39½	33¾-42⅞	23⅜-47¼
RETAIL FACILITIES (Areas in thousands of square feet)			
Stores—end of year:			
Food stores	1,318	1,428	1,418
Drug stores	618	606	563
Convenience stores	443	352	352
Total square feet—end of year:			
Food stores	43,939	46,077	44,088
Drug stores	6,958	6,832	6,261
Convenience stores	1,057	809	807

(a) In 1979, the Company changed from the First-In, First-Out (FIFO) method of valuing certain of its inventories to the Last-In, First-Out (LIFO) method.
(b) 1976 and 1980 were fifty-three week years.

1981	1980(b)	1979(a)	1978	1977	1976(b)	1975
13,957,555	12,616,082	10,937,415	9,467,874	8,117,709	7,396,095	6,486,531
280,608	215,515	191,008	208,466	157,313	123,550	94,892
103,299	81,627	77,090	93,533	69,457	53,157	41,135
177,309	133,888	113,918	114,933	87,856	70,393	53,757
3.87	3.03	2.59	2.63	2.03	1.65	1.26
1.57	1.40	1.26	.89	.76	.69	.68
951,773	900,095	896,147	796,183	703,358	628,866	560,586
405,065	246,011	271,211	320,461	311,844	313,053	230,772
1,339,626	1,138,287	962,018	814,377	728,186	685,704	655,469
2,964,017	2,483,504	2,232,134	2,023,767	1,843,236	1,711,128	1,535,444
477,501	311,036	269,026	239,172	247,060	274,310	229,194
187,516	173,268	169,561	165,856	153,958	147,883	130,111
1,000,049	835,066	762,194	692,894	611,169	550,937	505,837
21.33	18.84	17.26	15.82	14.12	12.88	11.85
409,605	350,972	205,944	217,674	167,797	141,455	100,589
324,280	298,766	242,324	168,543	127,944	107,757	92,181
163,779	147,877	127,269	112,138	98,455	90,237	80,074
55,583	44,662	36,849	35,920	36,912	33,425	30,511
19¼-27⅞	14-23¾	17½-27	12¾-18½	11⅝-14⅜	8⅞-12⅝	7⅞-12⅛
1,475	1,459	1,438	1,406	1,384	1,362	1,400
507	514	504	487	528	558	551
349	333	326	290	189	186	187
43,615	40,846	38,341	36,113	33,729	31,556	30,707
5,715	5,841	5,657	5,591	6,108	6,399	6,234
800	732	718	638	400	372	375

Corporate Officers

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Group Vice President

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Chairman of the Board,
Dillon Companies, Inc.

Richard W. Dillon
Vice Chairman of the Board,
Dillon Companies, Inc.

Walter R. Dryden
Group Vice President

Lyle Everingham
Chairman of the Board and
Chief Executive Officer

Jack G. Hudson
Vice President and Controller

George L. Irwin
Group Vice President

Arthur Juergens
Group Vice President

William G. Kagler
President

Lorrence T. Kellar
Vice President

Richard M. Koster
Senior Vice President

George A. Leonard
Vice President, Secretary
and General Counsel

Joseph A. Pichler
President, Dillon Companies, Inc.

Robert E. Saffron
Vice President

William J. Sinkula
Group Vice President

John L. Strubbe
Group Vice President

Lawrence M. Turner
Treasurer

Gerald L. Wolken
Vice President
President, SupeRx Drug Stores

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and The Seagram Company Ltd.

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Chairman of the Board and President
American District Telegraph Company

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Chairman of the Board
Dillon Companies, Inc.

Richard W. Dillon[7]
Vice Chairman of the Board
Dillon Companies, Inc.

Lyle Everingham[4,6]
Chairman of the Board and
Chief Executive Officer
The Kroger Co.

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Chairman of the Board and
Chief Executive Officer
Entex, Inc

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The Kroger Co.

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Business Administration
University of Michigan
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Executive in Residence
School of Business
University of Louisville

Thomas H. O'Leary[1,5]
Vice Chairman
Burlington Northern Inc.

John D. Ong[5,6]
Chairman and Chief Executive Officer
The B. F. Goodrich Company

Joseph A. Pichler[3]
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Dillon Companies, Inc.

Dr. W. George Pinnell[2,5]
Executive Vice President
Indiana University

Otis M. Smith[1,3]
Of Counsel
Lewis, White & Clay

Russell L. Wagner[1,2,6]
Retired former Chairman of the Board
and Chief Executive Officer
NLT Corporation

Committees of the Board of Directors:
[1]Audit
[2]Compensation
[3]Corporate Responsibility
[4]Executive
[5]Financial Policy
[6]Nominating
[7]Pension Plans

Form 10-K
A copy of the Company's 1984 report to the Securities and Exchange Commission, Form 10-K, is available to shareowners on request by writing: Lawrence M. Turner, Treasurer, The Kroger Co., 1014 Vine Street, Cincinnati, Ohio 45201.

Annual Meeting
The annual meeting of shareowners will be held at the Cincinnati Convention Center, Fifth and Elm Streets, Cincinnati, Ohio, on May 17, 1985, at 10 a.m.

Transfer Agent and Registrar
The First National Bank of Cincinnati
First National Bank Center
Fifth and Walnut Streets
Cincinnati, Ohio 45201
Telephone: In Cincinnati, call 632- 4450; in other parts of Ohio, call 1-800-346-7500; other areas, call 1-800-354-0400

Independent Certified Public Accountants
Coopers & Lybrand
1500 Atrium One
201 East Fourth Street
Cincinnati, Ohio 45202

Design Wolf Blumberg Krody, Inc
Typesetting Sue Braun, Kroger Corporate Advertising
Printing Nielsen Lithographing Co

Shareowners
At the end of 1984, a total of 45,428 shareowners of record owned 45,085,783 shares of The Kroger Co. common stock.

Common Stock
The main trading market for The Kroger Co.'s common stock is the New York Stock Exchange, where it is listed under the symbol KR.

Shareowner Inquiries
If shareowners have any questions regarding their Kroger stock account or if there are any problems such as missing dividend checks or changes of address, please direct inquiries to:

The First National Bank of Cincinnati
Stock Transfer Department
First National Bank Center
Fifth and Walnut Streets
Cincinnati, Ohio 45201
Telephone: See numbers for Transfer Agent, at left.

Dividend Reinvestment and Optional Cash Purchase Plan
The Dividend Reinvestment Plan permits shareowners to reinvest their dividends in Kroger common stock without service charges or brokerage fees. In addition, participating shareowners, under the Voluntary Contribution provision, may make cash purchases of additional Kroger common stock on the same cost-free basis. For full details and enrollment information about the Plan, please write to the Transfer Agent, at the address shown in first column.

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(513) 762-4000